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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 75-1870

E. I. DU PONT DE NEMOURS AND COMPANY, ET AL.,
Petitioners,

v.

RICHARD J. COLLINS, JR., ET AL., *Respondents.*

No. 75-1872

SECURITIES AND EXCHANGE COMMISSION, *Petitioner,*

v.

RICHARD J. COLLINS, JR., ET AL., *Respondents.*

On Writs of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF OF PETITIONERS E. I. du PONT de NEMOURS AND COMPANY AND CHRISTIANA SECURITIES COMPANY

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TABLE OF CONTENTS

	Page
Opinions Below	1
Jurisdiction	2
Statutes Involved	2
Question Presented	3
Statement of the Case	3
Summary of Argument	8
Argument	11
I. In Applying to This Merger the Criteria Set Forth in the Investment Company Act the Commission Faithfully Discharged the Responsibility Delegated to It By Congress	11
A. The Commission Correctly Perceived That the Proposed Merger Consists in Substance of an Exchange of Du Pont Common Stock for Du Pont Common Stock	13
B. The Commission Properly Attached Primary Significance to the Value of Christiana's Assets—Essentially Du Pont Common Stock—in Approving the Proposed Merger Terms	15
C. On the Basis of Reasoned Analysis, the Commission Rejected Contentions That the Merger Terms Should Not Reflect the Value of Christiana's Holding of Du Pont Common Stock	22
Market Price of Christiana Stock	23
Benefits of the Merger	23
Earmarks of an Arm's Length Bargain	26
Impact on Market Price of Du Pont Stock	32

Page

II. The Court of Appeals Did Not Accord the Judgment of the Commission the Deference Required by the Investment Company Act and Decisions of this Court 36

Conclusion 40

Appendix A A-1

Appendix B B-1

TABLE OF AUTHORITIES

Cases:

Camp v. *Pitts*, 411 U.S. 138 (1973) 39
Central States Elec. Corp. v. *Austrian*, 183 F.2d 879 (4th Cir. 1950), *cert. denied*, 340 U.S. 917 (1951) .. 21
Federal Power Commission v. *Transcontinental Gas Pipe Line Corp.*, 423 U.S. 326 (1976) 39, 40
Federal Trade Commission v. *Mandel Brothers*, 359 U.S. 385 (1959) 21
Harriman v. *E. I. du Pont de Nemours and Co.*, 411 F. Supp. 133 (D. Del. 1975) 8, 18, 19, 27, 31
National Labor Relations Board v. *Boeing Co.*, 412 U.S. 67 (1973) 21
Niagara Hudson Power Corp. v. *Leventritt*, 340 U.S. 336 (1951) 14, 15
Norwegian Nitrogen Products Co. v. *United States*, 288 U.S. 294 (1933) 22
Otis & Co. v. *Securities and Exchange Commission*, 323 U.S. 624 (1945) 30
Pepper v. *Litton*, 308 U.S. 295 (1939) 27, 28, 29
Red Lion Broadcasting Co. v. *Federal Communications Commission*, 395 U.S. 367 (1969) 21-22
Saxbe v. *Bustos*, 419 U.S. 65 (1974)..... 21

Page

Securities and Exchange Commission v. *Central-Illinois Securities Corp.*, 338 U.S. 96 (1949) 30
Securities and Exchange Commission v. *Chenery Corp.*, 332 U.S. 194 (1947) 10, 12, 36, 38, 40
Trafficante v. *Metropolitan Life Ins. Co.*, 409 U.S. 205 (1972) 21
United States v. *National Ass'n of Securities Dealers, Inc.*, 422 U.S. 694 (1975) 16, 21
United States v. *Republic Steel Corp.*, 362 U.S. 482 (1960) 21

Administrative Agency:

Central States Elec. Corp., 30 S.E.C. 680 (1949) ...19, 20
Century Investors, Inc., 40 S.E.C. 319 (1960) 20
Delaware Realty and Inv. Co., 40 S.E.C. 469 (1961)..18, 25
Detroit and Cleveland Nav. Co., Investment Company Act Release Nos. 3082 and 3099 (July 27 and August 19, 1960) 18
Eastern States Corp., Investment Company Act Release Nos. 5693 and 5711 (May 28 and June 16, 1969) 18
Electric Bond and Share Co., Investment Company Act Release No. 5215 (December 28, 1967) 20
Harbor Plywood Corp., 40 S.E.C. 1002 (1962) 18, 25
Huyler's Investment Company Act Release Nos. 5773 and 5809 (August 13 and September 9, 1969) 18
New York Dock Co., 38 S.E.C. 754 (1958)..... 20
Southeastern Capital Corp., Investment Company Act Release Nos. 4110 and 4133 (December 23, 1964 and January 12, 1965) 20
Southport Commercial Corp., Investment Company Act Release Nos. 4165 and 4180 (February 17 and March 5, 1965) 18
Talley Industries, Inc., Investment Company Act Release No. 5953 (January 9, 1970) 19
Townsend Corp., Investment Company Act Release No. 4045 (September 2, 1964) 19

Page

STATUTES:

Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 *et seq.*:
- Section 2, 15 U.S.C. § 80a-2 4
- Section 9, 15 U.S.C. § 80a-9 11
- Section 10, 15 U.S.C. § 80a-10 11
- Section 15, 15 U.S.C. § 80a-15 11
- Section 16, 15 U.S.C. § 80a-16 11
- Section 17, 15 U.S.C. § 80a-17 .. 2, 4, 5, 6, 9, 10, 11, 12, 13, 17, 18, 19, 20, 21, 24, 26, 27, 28, 31, 32
- Section 18, 15 U.S.C. § 80a-18 .....11, 17
- Section 22, 15 U.S.C. § 80a-22 .....16, 21
- Section 23, 15 U.S.C. § 80a-23 .....11, 17
- Section 43, 15 U.S.C. § 80a-42 .....2, 38, 39

Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79 *et seq.*:
- Section 11, 15 U.S.C. § 79k 15

28 U.S.C. § 1254(1) 2

ADMINISTRATIVE REGULATIONS:

Treasury Regulation § 20.2031-1(b) 31

LEGISLATIVE MATERIAL:

Securities and Exchange Commission Report on Investment Trusts and Investment Companies, Part One, H.R. Doc. No. 707, 75th Cong., 3d Sess. (1938); Part Two, H.R. Doc. No. 70, 76th Cong., 1st Sess. (1939); Part Three, H.R. Doc. No. 279, 76th Cong., 1st Sess. (1939); Parts Four and Five, H.R. Doc. No. 246, 77th Cong., 1st Sess. (1941) .. 16

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BRIEF OF PETITIONERS E. I. du PONT de NEMOURS AND COMPANY AND CHRISTIANA SECURITIES COMPANY

OPINIONS BELOW

The opinions and orders of the Securities and Exchange Commission ("Commission"), the majority and dissenting opinions of the Court of Appeals for the Eighth Circuit, the judgment of that Court, and

the order of that Court denying, by an equally divided vote, petitions for rehearing and suggestions for rehearing in banc are set out in the Appendix to the Commission's petition for a writ of certiorari in No. 75-1872.* The opinions and orders of the Commission were issued on December 13, 1974 and February 27, 1975 (Investment Company Act Release Nos. 8615 and 8692) and are not yet officially reported. The majority and dissenting opinions of the Court of Appeals were rendered on January 23, 1976 and are reported at 532 F.2d 584.

JURISDICTION

The judgment of the Court of Appeals was entered on January 23, 1976, and timely petitions for rehearing and suggestions for rehearing in banc were denied on February 26, 1976. The Commission and the petitioners were granted an extension of time to file petitions for writs of certiorari until June 25, 1976. The petition of E. I. du Pont de Nemours and Company ("Du Pont") and Christiana Securities Company ("Christiana") was filed on that day. The Commission was granted a further extension and filed its petition on June 26, 1976. Both petitions were granted on October 4, 1976, and the cases were ordered to be consolidated. The jurisdiction of the Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Sections 17 and 43 of the Investment Company Act, 15 U.S.C. §§ 80a-17, 42 are set out in relevant part in Appendix A to this brief.

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* That appendix will be referred to as "Pet. App." The Joint Appendix of the parties will be referred to as "A.".

QUESTION PRESENTED

Whether the Court of Appeals was warranted in rejecting the Commission's determination that the terms of the proposed merger of Christiana, a registered investment company, and its operating affiliate, Du Pont, are fair and reasonable and involve no overreaching, as required by the Investment Company Act of 1940, because they reflect the value of Christiana's assets, consisting almost exclusively of Du Pont common stock, which would be exchanged for Du Pont common stock in the merger; the Court of Appeals being of the view that the merger terms should reflect the price at which Christiana's common stock is traded in the market.

STATEMENT OF THE CASE

Du Pont and Christiana have entered into an agreement to merge. Christiana's principal holding, which constitutes in excess of 98 percent of its assets, is Du Pont common stock with a value of approximately $2 billion as of the date of the merger agreement, representing 28 percent of the total Du Pont common stock outstanding. The merger terms provide that Du Pont will receive for retirement all the Du Pont common stock held by Christiana, as well as Christiana's miscellaneous assets.[1] In return, Du Pont will issue in a tax-free exchange new shares of Du Pont common stock equal in value to 97.5 percent

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[1] Such assets consist of cash, a 3 percent interest in the Wilmington Trust Company, all the stock of a newspaper, The News-Journal Company, and a small holding of Du Pont preferred stock, which had, as of the time of the merger agreement, an aggregate net value of some $26 million. That valuation is not contested in these proceedings.

of Christiana's net asset value. Such value represents the market or appraised value of Christiana's assets less liabilities and minor adjustments for the expense of disposing of certain of those assets other than Du Pont stock. The manner in which net asset value was computed is set forth in Appendix B to this brief.

Neither Christiana nor Du Pont is under any compulsion—legal or otherwise—to merge. The merger was proposed by Christiana because its management, consisting of large stockholders who had been closely associated with Du Pont, concluded that Christiana had outlived its usefulness as a holding company for Du Pont stock. Because of the taxes incurred in continuing as a corporation and the discount from net asset value at which Christiana stock traded, it seemed desirable that Christiana stockholders become direct instead of indirect owners of Du Pont stock (Pet. App. 10a-13a; A. A104). The Du Pont management perceived no disadvantages to either Du Pont or its stockholders in the proposed merger and considered highly desirable, as a protection against uncertainties in the future, the dispersion of the ownership and vote of Du Pont stock that would be accomplished by the merger (A. A573).

Christiana is an investment company subject to regulation by the Commission under the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 *et seq.* Christiana and Du Pont are considered "affiliated persons" of each other under Section 2(a)(3) of the Act inasmuch as Christiana owns more than 5 percent of the outstanding stock of Du Pont. Section 17 of the Act makes it unlawful for an affiliated person of an investment company to purchase from that investment company any security or other property but provides

that the Commission shall issue an order granting an exemption from such prohibition if the evidence establishes that:

> "the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned. . . ." 15 U.S.C. § 80a-17(b)(1).

Under long-standing Commission interpretation of the Act, not contested here, a merger transaction is subject to Section 17. Accordingly, the terms of the proposed merger were negotiated and agreed upon with full realization that they would have to be approved by the Commission.

Christiana and Du Pont filed with the Commission a Joint Application for approval which was subsequently supplemented by six amendments (A. A81). The Notice of Application issued by the Commission to allow interested persons to file requests for hearing was sent by Christiana and Du Pont, respectively, to each of the approximately 8,000 Christiana stockholders and 225,000 Du Pont stockholders (A. A974).

The Commission ordered a hearing on the application, which was held before an Administrative Law Judge and extended over seven days. Three stockholders of Du Pont and one stockholder of Christiana participated in the hearing. Only the former objected to the merger terms. The evidence received at the hearing, in addition to the comprehensive application and amendments, included testimony from the parties' financial advisors,[2] members of the special committees

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[2] Morgan Stanley & Co., The First Boston Corporation and Kidder, Peabody & Co., Incorporated.

of each company's Board of Directors who had negotiated the terms of the merger, a senior Du Pont financial officer who was responsible for preparation of the merger documents, and a senior trust officer of Manufacturers Hanover Trust Company, which had a fiduciary responsibility for approximately 258,000 shares of Du Pont common stock, all in support of the merger terms. No witnesses were presented in opposition.

The Commission, acting unanimously in a comprehensive and reasoned Opinion, determined that the terms of the proposed merger were fair and reasonable and did not involve overreaching on the part of any person concerned, and granted the exemption provided for in Section 17(b).

The Commission took into account these salient factors in approving the merger terms. Christiana is owned by approximately 8,000 investors (Pet. App. 4a). Du Pont is a diversified chemical enterprise with approximately 47.5 million shares of common stock held by some 225,000 stockholders (Pet. App. 13a fn.34, 16a). Du Pont common stock is traded on the New York and other stock exchanges. Christiana stock, which is traded in the over-the-counter market (Pet. App. 4a), has historically sold at a discount of 20 to 25 percent from the market value of its assets (Pet. App. 13a). That discount appears to reflect the 7.2 percent federal income tax on intercorporate dividends that is payable by Christiana (Pet. App. 12a), the substantial potential capital gains tax that would be payable should Christiana sell its Du Pont stock for cash (Pet. App. 14a) and the comparatively thin trading in Christiana stock (Pet. App. 30a fn.51). The discount from the market value of Christiana's assets—which approximated $450 million prior to an-

nouncement of the merger negotiations—will be eliminated when the merger is consummated. Inasmuch as Du Pont will be issuing stock equal in value to 97.5 percent of Christiana's net asset value, the merger will benefit Du Pont stockholders by some $55 million (A. A94).

The Commission viewed the proposed merger as essentially an exchange of equivalents: Du Pont stock to be issued by Du Pont for the Du Pont stock presently owned by Christiana (Pet. App. 9a). It reasoned that an investment company, such as Christiana, whose assets consist of securities the values of which are determined in active markets, can normally be presumed to be worth its net asset value (Pet. App. 32a). The Commission, acting on the recommendation of its Division of Investment Management Regulation, considered and rejected the contentions advanced by the three objecting Du Pont stockholders as to why such value should not be looked to in this case. It found that the market value of Christiana common stock was not determinative of the merger terms, and that the merger would result in no detriment to Du Pont or its stockholders (Pet. App. 32a fn.57, 28a-31a). Moreover, the Commission concluded that any significant departure from net asset value as the basis for merger terms would be unfair because it would strip Christiana stockholders of some of the intrinsic value of their investment (Pet. App. 33a).[3]

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[3] The Commission approved the 2.5 percent discount from net asset value proposed by Du Pont and agreed to by Christiana, as being within the range of fairness (Pet. App. 35a-36a); that discount in favor of Du Pont stockholders was somewhat higher than any discount previously approved by the Commission (1.5%) or found in comparable transactions not subject to Commission approval (1.8%) (A. A244-A247, A687-A688).

In response to petitions for review filed by two of the objecting Du Pont stockholders, the Court of Appeals, in a 2-1 decision, joined in by a Senior District Judge from outside the Circuit, set aside the order of the Commission and thereafter declined to rehear the matter in banc. A majority of the Court of Appeals differed with the Commission in the following principal respects. The majority rejected net asset value as the lodestar in investment company valuation (Pet. App. 53a, 58a, 61a, 72a), regarded the market value of Christiana common stock as determinative (Pet. App. 58a), criticized the Commission for not ascertaining whether the merger terms bore the earmarks of an arm's length bargain (Pet. App. 61a), and found that fairness required the Christiana stockholders to surrender to Du Pont a significant portion of the tax savings achieved by the merger because, in the court's view, the "du Pont family" had retained over the years "the economic, political and social advantages that accompanies control of one of America's largest industrial concerns."[4] (Pet. App. 87a).

SUMMARY OF ARGUMENT

The Commission's action in approving the terms of the proposed merger of Du Pont and Christiana as fair and reasonable and reflecting no overreaching

[4] One of the respondents herein, Lewis C. Murtaugh, while the matter was under consideration by the Commission, brought a stockholder's derivative action claiming a violation of Delaware State Law and also of Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)). Following a full evidentiary hearing, that challenge was rejected by the United States District Court for Delaware in a comprehensive opinion that deals with the factual contentions advanced by the respondents and considered by the Court of Appeals. Harriman v. E. I. du Pont de Nemours and Co., 411 F.Supp. 133 (D. Del. 1975).

should be upheld. Those terms reflect in substance the exchange of equivalents—Du Pont common stock now owned by Christiana is to be exchanged for Du Pont common stock to be issued by Du Pont.

The Commission correctly determined that since the Investment Company Act was designed to protect the stockholders of investment companies against dilution of the inherent value of their investment, fairness under the Act requires that the merger terms be based upon the net asset value of Christiana. Such value consists almost exclusively of Du Pont common stock which is what Christiana is giving up and Du Pont is receiving in the merger.

The market price of Christiana common stock—which discounts its holding of Du Pont common stock by some 20 to 25 percent—does not measure Christiana's contribution to the merger. The medium of exchange for both parties to the merger is Du Pont common stock. The tax and market appreciation benefits that will flow to Christiana stockholders from the merger will constitute no detriment to Du Pont; that the benefits flowing to Du Pont are lesser in magnitude does not require that Christiana turn over to Du Pont a large portion of the tax savings and market appreciation that may accrue to Christiana stockholders. The Commission properly determined that its informed judgment as to fairness, reasonableness and overreaching, rather than the parties' bargain—however arm's length—should control in transactions subject to Section 17. Respondent Murtaugh's predictions that the merger would bring about massive selling with an adverse impact on the price of Du Pont common stock have, as the Commission found, no basis in fact. They reflect in large part a serious misconception on

his part as to the nature of this tax-free merger which, unlike a taxable divestiture, creates no need to sell stock either to pay taxes or to comply with a court order.

The Commission's action carries out the objectives of the Investment Company Act, is wholly consistent with the Commission's long-standing interpretation of Section 17(b), and finds support in other decisions by the Commission and courts in the regulation of public utility holding companies. It is not inconsistent with any decision of the Commission or that of any court. It constitutes the reasoned exercise by the Commission, based on its administrative experience and expertise, of a judgment in a matter, *i.e.*, fairness, as to which the Congress has delegated to the Commission broad authority. It is thus a judgment which is "entitled to the greatest amount of weight by appellate courts." *Securities and Exchange Commission* v. *Chenery Corp.*, 332 U.S. 194, 209 (1947). In addition, none of the considerations relied upon by the Court of Appeals or the respondents detracts from the conclusion that the merger terms agreed to by the parties and approved by the Commission are fair, reasonable and involve no overreaching.

The decision of the Court of Appeals setting aside the Commission's action is vitiated not only by that Court's failure to accord the Commission's judgment the deference required by Congress and by decisions of this Court, particularly *Chenery*, but also by its failure to follow proper appellate procedure.

ARGUMENT

I. IN APPLYING TO THIS MERGER THE CRITERIA SET FORTH IN THE INVESTMENT COMPANY ACT THE COMMISSION FAITHFULLY DISCHARGED THE RESPONSIBILITY DELEGATED TO IT BY CONGRESS.

Congress has delegated to the Commission responsibility for the administration of the Investment Company Act. Under that Act, investment companies are subject to comprehensive federal regulation. The Act speaks to such basic matters as issuance of stock and debt securities (Sections 18 and 23), approval of underwriting contracts and investment advisory agreements (Section 15), relationships with affiliated persons (Section 17), and composition of boards of directors (Sections 9, 10 and 16). Accordingly, for over thirty-five years the Commission has been intimately involved in every phase of financial activity of every registered investment company. Virtually no important corporate decision can be made by a registered investment company without the oversight of the Commission. Often, as here, a specific Commission order is required before action may be taken.

This comprehensive pattern of regulation rests upon a perception by Congress of the special character of investment companies. They differ in almost every relevant respect from industrial enterprises. Their earning power, for example, is not based on productive assets, research, development of products and marketing techniques; it is instead directly dependent upon dividends or interest from portfolio securities. The unique nature of investment companies and the special role of the Commission in their regulation were brushed aside by the Court of Appeals. Rather than reviewing the determination of the Commission as to fairness, the

Court below approached the merger of Christiana and Du Pont as if it involved two operating companies, wholly free from governmental regulation.

The decision of this Court in *Securities and Exchange Commission* v. *Chenery Corp.*, 332 U.S. 194 (1947), aptly describes the special competence of the Commission to make the Section 17(b) inquiry and determination in this case:

> "The Commission's conclusion here [as to the fairness of a reorganization under the Public Utility Holding Company Act] rests squarely in that area where administrative judgments are entitled to the greatest amount of weight by appellate courts. It is the product of administrative experience, appreciation of the complexities of the problem, realization of the statutory policies, and responsible treatment of the uncontested facts. It is the type of judgment which administrative agencies are best equipped to make and which justifies the use of the administrative process. See *Republic Aviation Corp.* v. *Labor Board*, 324 U.S. 793, 800. Whether we agree or disagree with the result reached, it is an allowable judgment which we cannot disturb." 332 U.S. at 209.

The Commission, as appears from its reasoned analysis of all aspects of the proposed merger, appreciated the problems presented, properly discerned the relevant statutory policies and brought to bear its considerable administrative experience in concluding that the merger terms are fair and reasonable and do not reflect overreaching on the part of any person.

A. The Commission Correctly Perceived That the Proposed Merger Consists in Substance of an Exchange of Du Pont Common Stock for Du Pont Common Stock.

Christiana now owns approximately 13.4 million shares of Du Pont common stock. In the merger it will surrender those shares to Du Pont along with certain miscellaneous assets. Du Pont will retire the shares received and in return issue slightly fewer shares of its own common stock—about 13.2 million—for distribution to Christiana stockholders. The Commission, in considering the terms of the proposed merger, concluded that "substantially, all that we are dealing with is an exchange of equivalents." (Pet. App. 9a). Accordingly, it found that the value of the Du Pont shares owned by Christiana, *i.e.*, net asset value, which it had uniformly looked to in similar transactions, was the appropriate measure of Christiana's contribution to the proposed merger and should be the basis for the merger terms.[5]

The Court of Appeals disagreed. In its view it was the market price of the Christiana common stock that should determine the merger terms. It thus viewed the relevant exchange as being Du Pont common stock for Christiana stock:

> "It is the current worth of the Christiana stock given in exchange for the Du Pont stock that must be determined in order to pass on the reasonableness and fairness of the merger." (Pet. App. 58a).

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[5] It is significant that under the operative language of Section 17 Du Pont, as an affiliated person of Christiana, may not "purchase from [Christiana] . . . any security or other property. . . ." Thus, the transaction passed upon by the Commission involves in essence Du Pont's proposed acquisition of the Du Pont stock held by Christiana, and accordingly it is the value of such stock to which the Commission must look.

This statement seriously misconceives the nature of the proposed merger. If two operating companies were to merge the relative market prices of their stock would be an important consideration, together with comparative earnings, dividends and other financial factors, in assessing the fairness of merger terms. The market price of an operating company's stock reflects the appraisal by the investment community of the operating assets, the skill of management, the potential for new products and increased earnings and other factors deemed important by investors.

The market price of Christiana common stock is determined by none of the foregoing factors or it would be essentially equal to the market price of the underlying Du Pont shares owned by Christiana. The discount, or difference between the net asset value and the market price of Christiana common stock, reflects the intercorporate dividend tax, the large capital gains tax which Christiana would be required to pay were it ever to sell its Du Pont holdings for cash and the relatively thin trading market for Christiana stock. All of these factors disappear in the merger. None of them detracts from the inherent value of Christiana's holding of Du Pont stock, which is what Du Pont receives in the merger.

The Court of Appeals' insistence that the merger terms reflect the market price of Christiana stock, and its refusal to accept the Commission's informed judgment as to fundamental investment values, is plainly at odds with this Court's decision in *Niagara Hudson Power Corp.* v. *Leventritt*, 340 U.S. 336 (1951). There, in upholding the Commission's determination that a plan of reorganization of a public utility holding

company was "fair and equitable" under Section 11 of the Public Utility Holding Company Act, the Court held that market prices were not controlling.

> "The informed judgment of the Commission, rather than that of the market, has been designated by the Act as the appropriate guide to fairness and equity within the meaning of the Act." 340 U.S. at 346-47.

As has been shown, the consideration to be exchanged by both Christiana and Du Pont consists essentially of shares of Du Pont common stock. Accordingly, the value of such shares should determine the terms of exchange, as the Commission held. The terms thus comport precisely with the test the Court of Appeals properly recognized but misapplied:

> "[T]he Commission must look to the value given and received by the respective shareholders to a merger. . . ." (Pet. App. 58a).

B. The Commission Properly Attached Primary Significance to the Value of Christiana's Assets—Essentially Du Pont Common Stock—in Approving the Proposed Merger Terms.

The significance attached by the Commission to Christiana's net asset value, *i.e.*, its holding of Du Pont common stock, is fully in accord with the basic objectives of the Investment Company Act. The Congressional declaration of policy, the structure of the Act, and judicial and Commission interpretations support the conclusion that investment company stockholders are to be protected against dilution of net asset value.

A comprehensive study of investment companies by the Commission, carried out pursuant to a specific

Congressional directive, laid the groundwork for the Act. *Report on Investment Trusts and Investment Companies.*[6] In Part Three of that Report, the Commission stated that net asset value is the fundamental basis for investment company valuation, and Congress accepted net asset value as the cornerstone of the Act.

> "To the investor not concerned with the immediate salability of his investment company security, asset value represents the actual value of his interest in his company; it constitutes the value of his property interest in the company, were it to be immediately dissolved." *Report on Investment Trusts and Investment Companies—Part Three, Abuses and Deficiencies in the Organization and Operation of Investment Trusts and Investment Companies,* H.R. Doc. No. 279, 76th Cong., 1st Sess. (1939) at 1396-97.

In *United States* v. *National Ass'n of Securities Dealers, Inc.,* 422 U.S. 694 (1975), this Court, in reviewing the legislative history of Section 22 of the Act, noted that one of the abuses at which it was aimed was selling practices under which the "equity interests of shareholders would suffer a . . . dilution." 422 U.S. at 709. The Court of Appeals accepted the importance of protecting net asset value in investment company regulation but only for open-end investment companies, which have outstanding securities redeemable at net asset value at the option of the holder. The Court of Appeals believed that the Commission had confused

[6] Part One of the Report is printed as H.R. Doc. No. 707, 75th Cong., 3d Sess. (1938). Part Two of the Report is printed as H.R. Doc. No. 70, 76th Cong., 1st Sess. (1939). Part Three is printed as H.R. Doc. No. 279, 76th Cong., 1st Sess. (1939). Parts Four and Five are printed as H.R. Doc. No. 246, 77th Cong., 1st Sess. (1941).

open-end investment companies with closed-end investment companies (Pet. App. 57a).

The Commission was well aware, however, of the distinction between the two types of investment companies but found no policy distinction which justified different treatment under Section 17. As the Commission noted, at the time the Act was passed, the phenomenon of market discount from net asset value was a factor that was common to closed-end companies such as Christiana, which do not extend a standing offer to redeem their securities (Pet. App. 32a fn. 57). Congress provided that this market phenomenon would not result in the dilution of the interest of stockholders in closed-end companies. Thus, Section 23(b) of the Act directs that no closed-end company "shall sell any common stock of which it is the issuer at a price below the current net asset value of such stock" with certain exceptions not here relevant. In addition, Section 18(a) of the Act strictly limits the issuance of debt or preferred stock by a closed-end company. The purpose of this limitation is to prevent undue dilution of net asset value in a falling market by reason of "leverage" attributable to senior securities.[7] Section 18(d), moreover, makes it unlawful for all investment companies to issue warrants or rights to purchase their own stock except exclusively and ratably to their own stockholders and further subject to the requirement that such rights may not extend beyond 120 days. Stockholders of investment companies are the only persons who may share in option benefits; to the extent that options ex-

[7] In a leveraged investment company, the net asset value of common stock would fall more rapidly in a declining market than the decline in the market value of the company's assets since senior securities would retain a fixed interest in those assets.

tending over the limited period permitted may involve some dilution of net asset value, outsiders may not benefit. The structure of the Act thus supports the Commission's view, rather than that of the Court of Appeals, that protection of net asset value extends to closed-end investment companies as well as open-end companies.

In requiring that the merger terms reflect the value of Christiana's assets the Commission also drew upon its own substantial experience in comparable transactions under Section 17(b) of the Act. In at least six earlier cases the Commission had passed upon the reorganization of a closed-end investment company and its affiliate when the principal securities holding of the investment company was stock of the affiliate.[8] In each case, the Commission determined that merger terms based on net asset value were fair, notwithstanding that the market price of the investment company's own stock, wherever a market existed, was significantly below such value.[9] In reviewing the Commission's established practice in these cases, the District Court in *Harriman* v. *E. I. du Pont de Nemours and Co., supra,* noted that:

[8] Huyler's, Investment Company Act Release Nos. 5773 and 5809 (August 13 and September 9, 1969); Eastern States Corp., Investment Company Act Release Nos. 5693 and 5711 (May 28 and June 16, 1969); Southport Commercial Corp., Investment Company Act Release Nos. 4165 and 4180 (February 17 and March 5, 1965); Harbor Plywood Corp., 40 S.E.C. 1002 (1962); Delaware Realty and Inv. Co., 40 S.E.C. 469 (1961); Detroit and Cleveland Nav. Co., Investment Company Act Release Nos. 3082 and 3099 (July 27 and August 19, 1960).

[9] Stock of Delaware Realty and Southport was closely held and had no public market.

> "The Securities and Exchange Commission, the agency authorized by Congress to implement the 1940 Act and pass upon otherwise prohibited transactions between investment companies and their affiliates . . . has consistently utilized net asset value as the controlling factor in section 17 proceedings. . . . This has been true notwithstanding the fact that the market value of the applicant investment company's stock was significantly lower than its net asset value. . . . Net asset value has also been utilized where no market existed for the common stock of an applicant investment company." 411 F.Supp. at 160.[10]

[10] The Court of Appeals refused to accord any weight to the Commission's long-standing position because of other Section 17(b) decisions, involving different types of companies, where net asset value was not the controlling factor. In the decisions cited by the Court of Appeals, however, the Commission was dealing with valuation not of investment companies whose sole assets consisted of marketable securities but of either "hybrid" investment companies which had operating assets or pure operating companies which fell within the ambit of Section 17 because of their affiliation with an investment company.

For example, the Court of Appeals cited Townsend Corp., Investment Company Act Release No. 4045 (September 2, 1964), in support of its position that the Commission has approved the valuation of an investment company on the basis of factors other than net asset value. In fact, the investment company's earnings there were used solely to compute the value of some of the investment company's assets which did not have an active market—its 100 percent ownership of certain radio stations. The Court of Appeals cited Central States Elec. Corp., 30 S.E.C. 680 (1949), as a case where net asset value was adjusted for the potential capital gains tax on unrealized appreciation of assets. The adjustment in that case related to assets that were to be sold in taxable transactions; here Christiana's holding of Du Pont stock is to be exchanged in a tax-free merger. Other decisions cited by the Court of Appeals in which the Commission departed from net asset value either involved the valuation of operating companies, Talley Industries, Inc., Investment Company Act Release No. 5953 (January 9, 1970), or involved the valuation of companies which were actually part invest-

Recognition of net asset value as the proper basis for investment company reorganizations has not been limited to transactions subject to Section 17(b). In *Central States Elec. Corp.*, 30 S.E.C. 680 (1949), the Commission recommended that net asset value, which it characterized as a "basic requirement" of valuation under the Investment Company Act, be used for bankruptcy reorganization purposes as well.

> "In the case of investment companies, such as the Debtor and its subsidiaries, which invest, reinvest, and deal in marketable securities, market prices are customarily used in appraising the value of their assets as well as their outstanding securities. * * * There are no fixed assets or equipment dedicated to a particular function; a specialized service is rendered only in the sense that the company offers diversification of investment and management of assets. In view of these characteristics, it is natural that net asset value based upon market prices should be the fundamental valuation criterion used by and large in the investment company field. In the absence of special circumstances, these characteristics constitute compelling reasons for considering net asset value as the primary measure of value of an investment company for reorganization purposes also." 30 S.E.C. at 700 (footnote omitted).

The District Court approved a plan of reorganization that reflected net asset value. The Court of Appeals affirmed its action, quoting with approval the language

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ment company business and part operating business. Electric Bond and Share Co., Investment Company Act Release No. 5215 (December 28, 1967); Southeastern Capital Corp., Investment Company Act Release Nos. 4110 and 4133 (December 23, 1964 and January 12, 1965); New York Dock Co., 38 S.E.C. 754 (1958); Century Investors, Inc., 40 S.E.C. 319 (1960).

of the Commission set forth above. *Central States Elec. Corp.* v. *Austrian*, 183 F.2d 879, 884 (4th Cir. 1950), *cert. denied*, 340 U.S. 917 (1951).

It is well established that the long-standing administrative policy of the Commission is entitled to great weight.[11] Most recently, in *United States* v. *National Ass'n of Securities Dealers, Inc., supra*, the Court deferred to the Commission's consistent interpretation of the term "dealer" in Section 22(d) of the Act, as reflected in official statements of the Commission as well as determinations under the Act:

> "This consistent and longstanding interpretation by the agency charged with administration of the Act, while not controlling, is entitled to considerable weight." 422 U.S. at 719.[12]

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[11] The Court of Appeals rejected the Commission's interpretation in part because many of the Section 17(b) proceedings were uncontested or not reviewed by any court (Pet. App. 62a-63a). As this Court has held, however, administrative interpretation may be established in many ways other than formal decisions following contested proceedings. In FTC v. Mandel Brothers, 359 U.S. 385 (1959), a consistent administrative construction that a sales slip constituted an invoice for purposes of the Fur Products Labeling Act was accorded great weight "even though it was applied in cases settled by consent rather than in litigation." 359 U.S. at 391. *See also*, United States v. Republic Steel Corp., 362 U.S. 482 (1960) (informal construction of Rivers and Harbors Act by Corps of Engineers); Trafficante v. Metropolitan Life Ins. Co., 409 U.S. 205 (1972) (informal construction of Civil Rights Act by Department of Housing and Urban Development); Saxbe v. Bustos, 419 U.S. 65 (1974) (informal interpretation of Immigration and Nationality Act by Immigration and Naturalization Service).

[12] Deference to a long-standing administrative position is not, of course, unique to the Commission or the Investment Company Act. It has been applied by this Court in upholding administrative construction of a wide variety of statutes. See, *e.g.*, NLRB v. Boeing Co., 412 U.S. 67, 74-75 (1973) (NLRB lacks authority to regulate reasonableness of union fines); Red Lion Broadcasting

The utilization of the value of Christiana's assets to determine the terms of the proposed merger implements both the policy and language of the Investment Company Act, is consistent with the Commission's long-standing interpretations and should be approved by this Court under established principles of review.

C. On the Basis of Reasoned Analysis, the Commission Rejected Contentions That the Merger Terms Should Not Reflect the Value of Christiana's Holding of Du Pont Common Stock.

While the Commission concluded that fairness under the Investment Company Act required that the merger terms in this transaction reflect net asset value (Pet. App. 17a, 35a-36a), it reached that conclusion after consideration of an evidentiary record that set forth all other possible indicia of value, *e.g.*, market price, earnings, book value, etc. Because those factors were so clearly inappropriate in a transaction involving an exchange of equivalents, the Commission reached the ultimate conclusion that in this case the governing standard precluded use of any criterion other than net asset value.

The Commission carefully considered whether any of the contentions advanced by the respondents—which the Court of Appeals accepted in substance—warranted a departure from the use of net asset value in approving the terms of the proposed merger. The Commission analyzed those contentions and concluded that none of them altered the central and controlling fact that the merger would consist of

Co. v. FCC, 395 U.S. 367, 380-81 (1969) (FCC's view that fairness doctrine is in the public interest upheld); and Norwegian Nitrogen Products Co. v. United States, 288 U.S. 294, 315 (1933) (Tariff Board policy of maintaining confidentiality of production costs of individual firms under investigation upheld).

an exchange of Du Pont common stock for Du Pont common stock. As the Commission viewed the matter, only if the merger could reasonably be expected to cause some harm or detriment to Du Pont or its stockholders should the Christiana stockholders receive significantly less than the value of their assets.

> "Only if [the] decision to dismantle Christiana inflicts cognizable harm on Du Pont and on its stockholders unrecompensed by the proposed discount, can we insist on terms harsher for them than those now before us." (Pet. App. 21a-23a).[13]

Market Price of Christiana Stock. At the forefront of the Commission's consideration of the proposed merger terms was clear recognition that the market price of Christiana common stock was from 20 to 25 percent below the market value of Christiana's assets. The factors creating the discount are, however, tax and market factors—peculiar to Christiana as a corporate entity—which would disappear in the merger. Moreover, as has been shown (*supra*, pp. 13-15), it was not Christiana stock but Du Pont stock which Du Pont was receiving in the merger. The Commission also reasoned that Christiana stock was held principally by long-term investors and that to utilize its market price would have the effect of stripping from those investors a significant portion of the intrinsic value of their investment (Pet. App. 32a-33a).

Benefits of the Merger. The Commission was fully aware that there was an imbalance in the benefits flowing from the merger:

[13] Because Christiana stockholders would share in the discount as Du Pont stockholders, the actual dilution incurred by Christiana stockholders would be 1.8 percent (Pet. App. 13a).

> "The very slight reduction in the amount of Du Pont's outstanding common and the resulting increase in earnings per Du Pont common share is incommensurate with the tax and the market value benefits inuring to the Christiana stockholders." (Pet. App. 18a).

As the Commission found, the benefits to Christiana arise principally as the result of federal tax laws and stock market phenomena (Pet. App. 10a-11a). Its dividend income is taxed at a 7.2 percent federal tax rate. In addition, it does not appear to have immediately available to it any alternative course of action whereby its Du Pont stock could be distributed directly to its stockholders without significant and perhaps immeasurable tax effect.[14] Hence the final terms of the proposed merger, as well as the Commission's decision, reflect a recognition that the merger would be the only way of terminating Christiana's existence without adverse tax impact.[15]

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[14] During the course of merger negotiations the parties devoted considerable attention to the possibility that Christiana might utilize a special form of liquidation under Section 333 of the Internal Revenue Code which would have reduced the tax impact of a distribution of Du Pont stock to its stockholders. Ultimately it was concluded that this route was too uncertain to pursue because there was no way to determine in advance the potential tax liabilities of the Christiana stockholders (A. A877-A879).

[15] The Court of Appeals erred in asserting that the Commission's use of net asset value in applying Section 17(b) was limited to situations in which the investment company had available alternative methods of placing its assets in the hands of its stockholders without significant tax cost or other expenses (Pet. App. 63a-64a). Nothing in the language of the Act, the legislative history or the Commission's decisions would so limit the use of net asset value under Section 17. Moreover, in at least two instances the Commission has held merger terms based on net asset value to be fair notwithstanding the fact that, as here, there were no feasible alternatives to merger. In Harbor Plywood, *supra*, the evidence submitted at hearings indicated that liquidation was not financially feasible as an alternative to the merger because of tax and other considerations. Delaware Realty and Inv. Co., *supra*, involved a 1961 merger of Delaware Realty into Christiana. Delaware Realty owned approximately 33 percent of outstanding Christiana common stock, accounting for the bulk of its assets. Christiana's holdings then, as now, were principally in Du Pont common stock. Delaware Realty's net asset value was computed, not with respect to the market value of its block of Christiana stock, but rather as if Delaware Realty owned directly the Du Pont common stock held by Christiana. Both Delaware Realty and Christiana would have had to liquidate or to adopt exchange plans for Delaware Realty stockholders to achieve by other means underlying net asset value in terms of Du Pont stock, and, as the Commission opinion indicated, such alternatives would have involved tax problems. 40 S.E.C. at 473.

The Court of Appeals held that the Commission was required in its consideration of the proposed merger terms to allocate to Du Pont a share of the tax savings that Christiana and its stockholders might achieve by reason of the merger on the ground that "fairness requires that Du Pont share in the tax savings that result from its cooperation." (Pet. App. 86a fn.35).

In expressly rejecting this approach, the Commission said:

> "The heart of the matter is that the tax benefits to be reaped by the Christiana people will inflict no corresponding detriment on Du Pont or on its stockholders." (Pet. App. 23a fn.44).

This is not a taxable transaction, but a tax-free merger. The Internal Revenue Service has issued a ruling that the receipt of Du Pont stock by the stockholders of Christiana will not be a taxable transaction under the Internal Revenue Code.[16] Under the Court of Appeals' view, Christiana stockholders

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[16] Pet. App. 93a fn. 4.

would be required to pay to Du Pont some major portion of the capital gains tax which would have been payable were this not a tax-free transaction."[17] As the Commission held, Du Pont has no property interest in the tax saving achieved by any Christiana stockholder (Pet. App. 24a).

Earmarks of an Arm's Length Bargain. The Court of Appeals misconceived the essential purpose of the Investment Company Act in its demand that the Commission disapprove the merger terms unless it found that they would have been reached in an arm's length bargain (Pet. App. 61a). The Commission quite properly viewed its responsibility as being to determine whether the proposed terms were fair and reasonable or reflected overreaching, as Section 17 provides. It declined to rely upon the substantial evidence that showed, despite the long and close relationship between the parties, complete independence of action by both Christiana and Du Pont in the negotiation of the merger terms.[18] It held that the manner in which

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[17] It should be noted that the asserted savings of capital gains tax to Christiana stockholders are in reality deferrals of tax. Any former Christiana stockholder who sells Du Pont stock received in the merger will be required to pay a full capital gains tax based on the difference between the amount realized on such sale and the tax basis for the Christiana stock which is presently owned. Moreover, approximately 11 percent of Christiana stock is held by tax-exempt institutions that would pay no capital gains tax (A. A845).

[18] The evidence before the Commission establishes that the transaction did in fact carry the earmarks of an arm's length bargain. Among the factors supporting this conclusion are the following:

(a) The judgment of three independent financial advisers retained by the parties, The First Boston Corporation, Morgan Stanley & Co. and Kidder, Peabody & Co., Incorporated, was that the merger terms should approximate net asset value (A. A698-A699, A705-A706; A. A631-A632, A636-A637; A. A842-A844).

such terms were arrived at was of no consequence; what was significant was whether the ultimate terms met the statutory standard (Pet. App. 35a fn.62).

What the Court of Appeals failed to recognize was that Congress, in Section 17 of the Act, substituted the Commission's informed impartial judgment and the "fair, reasonable and no overreaching by any person" test for the results of arm's length bargaining. Cf. *Pepper* v. *Litton*, 308 U.S. 295 (1939). Arm's length bargaining is at best a crude and inexact

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(b) Christiana had been valued at net asset value for purposes of Section 17(b) on at least three prior occasions: its own merger with Delaware Realty and Investment Co., which held 33 percent of Christiana stock, 40 SEC 469 (1961) and two exchange offers of portfolio securities with its stockholders (Pet. App. 64a).

(c) The Du Pont Negotiating Committee consisted of two senior executives who had no affiliation with Christiana. The Christiana negotiators held no positions with Du Pont. Those members of Du Pont's Board of Directors affiliated with Christiana took no part in the negotiations of the terms or the approval by the Du Pont Board (A. A91-A92).

(d) The 2.5 percent discount which was demanded by Du Pont is the largest discount ever accepted as fair by the Commission under Section 17(b), and is greater than the discount reflected in any comparable transaction not requiring Commission approval (A. A687-A688).

(e) Christiana, which was under no compulsion to merge, would not have accepted a discount greater than 2.5 percent (A. A563).

The District Court in Harriman v. E. I. du Pont de Nemours and Co., *supra*, expressly rejected the allegation of the plaintiffs in that case that Du Pont did not bargain at arm's length.

> "Since plaintiffs did not produce a scintilla of evidence that improper motivations or divided loyalties were responsible for what the Court regards as a sound negotiating strategem which ultimately resulted in a discount higher than any previously approved by the SEC, they cannot succeed on this facet of their case." 411 F. Supp. at 164.

method of determining fairness. It is little more than the law of the commercial and financial jungle. In applying the criteria of Section 17, the Commission recognized that its duty was to determine fairness objectively and not to be satisfied if the transaction merely "carries the earmarks of an arm's length bargain." *Pepper* v. *Litton*, 308 U.S. at 306-07.

Du Pont and Christiana were aware, too, from the outset of negotiations that neither was free to bargain in the spirit of a pawnbroker. Section 17 requires that the terms be fair to all concerned. In transactions not subject to Section 17 or a similar fairness standard, each party can attempt to utilize its strategic bargaining position with no holds barred. In this case the parties were advised that both financial and legal precedents dictated terms that reflected net asset value with a modest discount. In examining the terms agreed to by the parties the Commission speculated that Du Pont "in the course of bargaining between wholly unrelated parties" might have exacted a higher price for its agreement to merge (Pet. App. 24a). It observed, however, that a principal reason why Section 17 was enacted was "to prevent persons in a strategic position from using that position to effect transactions for other than fair value," (Pet. App. 24a-25a). Its reasoning makes clear why the Court of Appeals erred in demanding an arm's length inquiry rather than that provided in Section 17:

> "It is precisely because transactions of this character are replete with inherent conflicts of interest that the Act requires that they be submitted to us. As we said in *Atlas Corporation*, 37 S.E.C. 72, 85-86 (1956): 'It is evident that Section 17 of the Act was not designed to prohibit transactions solely for the reason that they are not

> negotiated at arm's-length. On the contrary, Section 17(b) of the Act directs us to exempt transactions between controlling or affiliated persons where the evidence establishes that the terms thereof are reasonable and fair and do not involve overreaching on the part of any person concerned. Clearly, Section 17 contemplates that transactions meeting these standards will be permitted although arm's-length bargaining may not have been present or, indeed, may have been impossible in view of the relationship of the parties.'" (Pet. App. 35a fn.62).

An arm's length bargain may involve such factors as negotiating tactics, strength of position, and so forth. Rarely is such a bargaining process concerned with fundamental investment values. It is the latter to which the Commission's judgment must, under the Act, be directed. Thus it would have been inappropriate for the Commission to attempt to ascertain whether the parties had bargained as if this were an ordinary commercial transaction, rather than a fundamental corporate realignment.

It may be that the fault found by the Court of Appeals in the Commission's inquiry into the proposed merger terms rests largely on semantics. In extolling *Pepper* v. *Litton* and related cases and urging that the arm's length bargaining principle is of "general application to corporate law and equity," the court concluded that such a principle "characterizes the type of unbiased scrutiny" that is essential in reviewing reorganizations (Pet. App. 61a fn.15). It cannot be questioned that in this case the Commission gave the proposed merger a full measure of "unbiased scrutiny." That it employed the relevant statutory test

rather than a more generalized judge-made test only means that the transaction received the searching inquiry determined appropriate by Congress.

In any event it is well established by decisions of this Court that in the discharge of its special statutory responsibilities the Commission is to develop and apply criteria of fairness suitable to the Acts of Congress that it administers. *Otis & Co.* v. *Securities and Exchange Commission*, 323 U.S. 624 (1945); *Securities and Exchange Commission* v. *Central-Illinois Securities Corp.*, 338 U.S. 96 (1949). The teaching of such cases is that, in determining what is fair and equitable under the Public Utility Holding Company Act, the Commission must develop its own fairness standard based on the purposes of that Act. The Investment Company Act calls for a similar independent exercise of informed judgment by the Commission.

In *Otis*, although the plan of reorganization involved a liquidation in which the common stockholders would not have participated under the corporate charter provisions or "strict priority" rules applicable in bankruptcy, the Commission valued the interests of the common stockholders as though the company were a continuing enterprise. This Court upheld the Commission's determination of fairness:

> "Of course, Congress would wish, in simplifying a holding company system capital structure, to preserve values to investors, not to destroy them. Consequently, while giving the Commission power to compel the elimination of holding companies deemed uneconomic, it allowed the affected companies to propose plans to the Commission to effectuate the objects and the Commission to approve such plans when they were considered 'fair and equitable.'" 323 U.S. at 636-37.[19]

In administering Section 17 of the Investment Company Act the Commission is under a mandate from Congress to approve merger terms between an investment company and its affiliate if such terms are fair and reasonable and do not reflect overreaching on the part of any person.[20] In carrying out this mandate, the

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[19] As the Commission recognized (Pet. App. 21a fn. 42), the termination of Christiana's existence which would be accomplished by the proposed merger constitutes voluntary and desirable corporate simplification of a major industrial company similar to that which Congress has mandated for public utility companies. The Antitrust Division of the Department of Justice has urged in this Court the desirability of terminating the existence of Christiana (A. A694).

[20] While the Internal Revenue Code and the Delaware appraisal law are essentially irrelevant to the Commission's role in determining fairness under the 1940 Act, there is not, as the Court of Appeals suggested (Pet. App. 68a-72a), any inconsistency between the result reached here and the applicable provisions of those laws. In Harriman v. E. I. du Pont de Nemours and Co., *supra*, the District Court in passing upon the fairness of this proposed merger under Delaware law held that, since an appraisal proceeding is concerned with the statutory demand of the dissenter for an immediate cash payment for his stock, market price rather than net asset value may be the appropriate measure of value, but such market price does not govern the determination of fairness where the stockholder continues to have an on-going interest in the enterprise—as is the case in this merger. 411 F. Supp. at 155-56.

The estate and gift tax valuation cases cited by the Court of Appeals have no applicability. Those cases involve a tax based on "fair market value" of stock as of a particular date. The Tax Regulations define that value as the amount which would be paid in cash by a willing buyer to a willing seller. (Treasury Regulation Sec. 20.2031-1(b)). This revenue collecting concept has no place in the determination of fairness in mergers where the medium of exchange, on both sides of the transaction, is not cash but Du Pont stock, the receipt of which is not a taxable event.

Commission concluded that it would be unfair and unreasonable for Du Pont to appropriate from the Christiana stockholders, as the price of its agreement to merge, any significant portion of the increase in values that might flow to such stockholders as the result of tax savings—real and potential—and the stock market's appraisal of the value of stock held directly as compared with stock held indirectly through an investment company. Such appropriation on the part of Du Pont would have been, in the Commission's view, precisely the overreaching that Section 17 expressly forbids.

In rejecting the Commission's informed application of the "fair and reasonable and no overreaching" standard of Section 17(b), in favor of an "earmarks of an arm's length bargain" standard, the decision of the Court of Appeals would encourage—indeed demand—the very kind of "advantage-taking" that the Investment Company Act was intended to supplant.

Impact on Market Price of Du Pont Stock. Finally, the Commission considered at length the principal claim advanced by respondent Murtaugh that the merger would lead to such a volume of selling by former Christiana stockholders that the market price of Du Pont stock would be adversely affected over an extended period of time. The Commission viewed this as the "crux" of the case and carefully examined the extensive evidence that was adduced at the hearing (Pet. App. 25a). It determined that there was no evidence of long term adverse market impact and the Court of Appeals agreed (Pet. App. 90a fn. 39).

The Commission made specific findings that large Christiana stockholders lacked any present intention

or incentive to sell and that substantial post-merger sales were unlikely (Pet. App. 14a-15a, 25a fn.46). Such stockholders had for years been indirect investors in Du Pont and the merger would not change the essential nature of their investment—it would rest upon Du Pont's earnings and prospects. Moreover, there was no evidence that such stockholders had lost confidence in Du Pont and were desirous of bailing out. Indeed, the record shows that the directors of Christiana, who hold in the aggregate approximately 16 percent of the Christiana common stock, have no intention to sell Du Pont stock to be received in the merger and that Wilmington Trust Company, which holds in its trust department over 50 percent of Christiana common stock, likewise has no intention to sell, other than sales which might be required in connection with settlement of estates and similar administrative matters (A. A564-A566; A. A800-807).

As to the specific factors which would make selling unlikely, the Commission noted that the merger is conditioned upon the receipt of an Internal Revenue Service ruling that it will be tax free; thus former Christiana stockholders will be under no compulsion to sell to raise money to pay taxes (Pet. App. 7a, 34a fn.59). It also noted that there was no requirement of any kind—court order or otherwise—that forced any selling by Christiana stockholders so that each stockholder in deciding to sell or hold would be guided solely by his own investment judgment and self-interest (Pet. App. 33a-34a fn.59).[21] This circumstance the Commission saw

[21] The Commission found wholly unpersuasive the principal precedent advanced by respondent Murtaugh—the position taken by Du Pont in opposing a court order requiring the divestiture of its General Motors stock (Pet. App. 33a fn. 59). That divestiture, as proposed by the Government, did threaten to cause substantial

as a disincentive to selling. The Commission also found that "[m]ost of Christiana's stock has a very low basis in the hands of those who now hold it" because of the long-term nature of those holdings, and because of the reduction in tax basis resulting from distributions of General Motors stock pursuant to the divestiture by Du Pont of its interest in that company (Pet. App. 14a).

Based on all the evidence, the Commission specifically rejected respondent Murtaugh's claims of massive sales of Du Pont stock following the merger (Pet. App. 25a fn.46, 26a). The Commission went on to deal with the matter of what effect, if any, the occasional sales which it was agreed could take place might have on the market price of Du Pont stock, accepting as an assumption that there might be selling which "at certain points in time [would] be substantial." (Pet. App. 26a). The Commission's reasoning was based on its own expertise and knowledge of how securities markets operate.

> "[T]he merger might possibly engender selling of a volume that could on occasion cause Du Pont's market price to dip below the level at which it would otherwise stand. . . . We . . . conclude that such depressing effects on the price of Du Pont common as may occasionally manifest themselves by reason of the proposed transaction will be of relatively brief duration." (Pet. App. 28a-29a).

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selling, but because of two factors not present here: the distribution would have been taxable as a dividend at rates up to 90 percent; and substantial sales of General Motors stock would have been required by court order. Thus the Commission found "the General Motors situation had nothing in common with this one." (Pet. App. 33a-34a fn. 59).

The basis for the conclusion reached by the Commission was that Du Pont's earning power and the trend of those earnings will be the basic determinant of the market price of its stock. The Commission stated:

> "In no way will the Christiana merger detract from either the assets or the earning power of [Du Pont.] The fundamentals of the situation will remain as they are." (Pet. App. 28a).

In finding that the merger would cause no detriment to Du Pont as a result of the claimed adverse market impact, the Commission declined to attempt to measure that impact on the basis of any specific number of shares to be sold at any specific time. It first pointed out how little weight could be accorded any such attempt because of the highly speculative nature of such an effort (Pet. App. 30a-31a). It noted the impossibility of determining how much Du Pont stock was likely to come on the market by reason of the merger in any given period of time. Even if an amount were assumed or speculated, the Commission questioned whether its impact on market price could be reasonably estimated. It finally observed in this respect that even an attempt to look at market impact after the merger, with all of the facts available, would be of little help because stock prices are so

> "volatile and the factors that influence them multifarious"

that there is no known way of isolating the actual, let alone the probable, effect of a single factor such as increased stock sales resulting from the merger (Pet. App. 31a).

The Court of Appeals agreed with the Commission's principal conclusion that the merger would not ad-

versely impact the market price of Du Pont stock for any extended period of time. It criticized the Commission, however, for not taking into account the possible short-term market impact of occasional large sales (Pet. App. 90a). The court thus set for the Commission an impossible task. Having determined that future short-term market behavior was too elusive to measure, the Commission would nonetheless be required to appraise it in passing on the fairness of merger terms.

The Commission's refusal to speculate on short-term market behavior is further supported by the circumstance that in this merger the parties are exchanging equivalents. Du Pont is exchanging and receiving in return shares of Du Pont common stock. The inherent investment value of what is being surrendered is thus the same as the value of what is being received. So long as these values are in line the Commission was satisfied that the merger would result in no detriment to Du Pont or its stockholders. As the Commission concluded, "the simple, readily usable tool of net asset value does the job much better than an accurate gauge of market impact (were there one) could." (Pet. App. 32a).

II. THE COURT OF APPEALS DID NOT ACCORD THE JUDGMENT OF THE COMMISSION THE DEFERENCE REQUIRED BY THE INVESTMENT COMPANY ACT AND DECISIONS OF THIS COURT.

As has been shown, the Court of Appeals accorded no deference to the Commission's informed judgment on fairness and investment values. In so acting it violated the basic principle of judicial review established by decisions of this Court, particularly *Securities and Exchange Commission* v. *Chenery Corp., supra*.

> "The facts being undisputed, we are free to disturb the Commission's conclusion only if it lacks any rational and statutory foundation. In that connection, the Commission has made a thorough examination of the problem, utilizing statutory standards and its own accumulated experience with reorganization matters. In essence, it has made . . . an informed, expert judgment on the problem. * * * The 'fair and equitable' rule of § 11(e) and the standard of what is 'detrimental to the public interest or the interests of investors or consumers' . . . were inserted by the framers of the Act in order that the Commission might have broad powers to protect the various interests at stake. The application of those criteria . . . necessarily requires the use of informed discretion by the Commission. The very breadth of the statutory language precludes a reversal of the Commission's judgment save where it has plainly abused its discretion in these matters." 332 U.S. at 207-08 (citations omitted).

In addition, the procedure followed by the Court of Appeals in reviewing the Commission's order underscores the extent to which it went beyond proper judicial review in this matter. After receiving briefs and hearing argument, the Court of Appeals, over the objection of the Commission, Christiana and Du Pont, employed Professor Roger B. Upson, Associate Dean of the University of Minnesota College of Business Administration, "to assist the Court in understanding the record in this case and to prepare reports and memoranda for this Court in connection with that function." (Pet. App. 91a fn. 40; A. A981-A982). The report submitted by Professor Upson includes numerous data and observations that are not a matter of record, are not a proper subject of judicial notice and were, of course, at no time considered by the Commission which is charged by Congress with passing initial-

ly on all relevant evidence. For example, Professor Upson gave the greatest prominence in his report to an analysis performed by a Professor Halpern of some seventy-seven industrial mergers occurring in the period 1950-1965 (A. 985). That analysis, which does not deal with investment company mergers or recognize the difference between such mergers and those of industrial companies, drew the conclusion that any post-merger accretion in market value is divided, on the average, evenly between the two merger parties.[22] Applying this conclusion Professor Upson prepared and presented to the Court merger terms, quite different from those agreed to by the parties and approved by the Commission, which would have resulted in an approximately equal increase in the aggregate market value of Du Pont and Christiana (A. A985-A990). The mere consideration, *de novo*, of merger terms based on the Halpern study reflects the extent to which the Court departed from the *Chenery* principle of judicial review.

The Court of Appeals' jurisdiction to review orders of the Commission is specifically limited. The court may only:

> "affirm, modify, or set aside such order, in whole or in part . . . . The findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." 15 U.S.C. § 80a-42(a).

[22] In their comment on the Upson report filed with the Court of Appeals on December 22, 1975, Christiana and Du Pont included the data base for Professor Halpern's study. Analysis of this base shows that the average derived by the Professor is purely arithmetical and obscures such wide variations as to be useless as an analytical tool.

If additional evidence is deemed necessary, the matter must be remanded for additional proceedings by the Commission.

> ". . . If application is made to the court for leave to adduce additional evidence, and it is shown to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceeding before the Commission, the court may order such additional evidence to be taken *before the Commission* and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. . . ." 15 U.S.C. § 80-42(a) (emphasis added).

Thus Professor Upson's participation in the review of the Commission's decision was in conflict with the explicit directions of Congress.

This Court has cautioned in other contexts that "the focal point for judicial review should be the administrative record already in existence, not some new record made initially in the reviewing court." *Camp* v. *Pitts*, 411 U.S. 138, 142 (1973). And only recently a Court of Appeals has been criticized for going outside the record in reviewing the action of an administrative agency. *Federal Power Commission* v. *Transcontinental Gas Pipe Line Corp.*, 423 U.S. 326 (1976). Section 43(a) provides for review of the Commission's decision and the evidence on which it is based, and not review based on a record made in the reviewing court. The procedure followed by the Court of Appeals "clearly runs the risk of 'propel[ling] the court into the domain which Congress has set aside exclusively for the administrative agency.' " *Federal Power Com-*

mission v. *Transcontinental Gas Pipe Line Corp.*, *supra*, 423 U.S. at 333, quoting from *Securities and Exchange Commission* v. *Chenery Corp.*, *supra*, 332 U.S. at 196.

CONCLUSION

The decision of the Court of Appeals should be reversed and the action of the Commission, which constitutes a reasoned exercise of informed judgment on a matter clearly within its administrative experience, affirmed.

Respectfully submitted,

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APPENDIX

APPENDIX A

Section 17 of the Investment Company Act, 15 U.S.C. § 80a-17, provides in pertinent part:

> "§ 17(a) It shall be unlawful for any affiliated person or promoter of or principal underwriter for a registered investment company (other than a company of the character described in section 80a-12(d)(3)(A) and (B) of this title), or any affiliated person of such a person, promoter, or principal underwriter, acting as principal—
>
> (1) knowingly to sell any security or other property to such registered company or to any company controlled by such registered company . . .
>
> (2) knowingly to purchase from such registered company, or from any company controlled by such registered company, any security or other property . . .
>
> (b) Notwithstanding subsection (a) of this section, any person may file with the Commission an application for an order exempting a proposed transaction of the applicant from one or more provisions of said subsection. The Commission shall grant such application and issue such order of exemption if evidence establishes that—
>
> (1) the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned;
>
> (2) the proposed transaction is consistent with the policy of each registered investment company concerned, as recited in its registration statement and reports filed under this subchapter; and
>
> (3) the proposed transaction is consistent with the general purposes of this subchapter."

Section 43 of the Investment Company Act, 15 U.S.C. § 80a-42, provides in pertinent part:

> "§ 43(a) Any person or party aggrieved by an order issued by the Commission under this subchapter may obtain a review of such order in the United States court of appeals within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part. * * * Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record shall be exclusive, to affirm, modify, or set aside such order, in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission or unless there were reasonable grounds for failure so to do. The findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If application is made to the court for leave to adduce additional evidence, and it is shown to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceeding before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. * * *"

APPENDIX B

Computation of Adjusted Net Asset Value of Christiana for Merger Purposes

The value of Christiana's security holdings for purposes of the merger was determined as set forth in the following table:

Security	No of Shares	Value	
		Per Share	Total
Du Pont, Common Stock	13,417,120	$163.875	$2,198,730,540
Du Pont, $4.50 Preferred Stock	16,256	69.15	1,124,102
The News-Journal Co., Common Stock	7,460	—	24,260,000
Wilmington Trust Co., Common Stock	69,216	39.00	2,699,424
			$2,226,814,066

Values for Christiana's holdings of Du Pont Common Stock and Du Pont $4.50 Preferred Stock were computed by multiplying the respective number of sha. s held by Christiana by the respective average closing prices on the New York Stock Exchange on July 10 through 14, 1972, inclusive. Value for The News-Journal Co. Common Stock is its estimated fair value based upon an appraisal by Vincent J. Manno, an expert in the field. The value per share for Wilmington Trust Co. Common Stock is based on its average closing bid price in the over-the-counter market on July 10 through 14, 1972, inclusive.

Because Du Pont intends to hold the stock of Wilmington Trust Co. and The News-Journal Co. for only the period required for orderly disposition thereof, the net asset value of Christiana was adjusted for expenses and anticipated tax effect of the disposition of those securities. The adjustment for this purpose reflects the expense (estimated at 3% of market value) to dispose of the Wilmington Trust Co. stock, and federal income taxes at the rate of 30% on the long term capital gains which would result from sale of the two investments at the values thereof used for purposes of the merger.

Christiana and Du Pont will incur certain expenses in connection with the merger, estimated to total $1,500,000, which are to be shared equally by Christiana and Du Pont. Christiana's net asset value was adjusted to reflect its portion of the estimated merger expenses.

The assets of Christiana include a claim pending in the United States District Court for the District of Delaware for refund of federal income taxes and interest, carried on Christiana's books as of June 30, 1972 as a deferred charge in the amount of $11,723,013. As Christiana and Du Pont were unable to determine the fair value of the tax claim, it was treated as having no value, subject to a contingent distribution of Du Pont Common Stock upon settlement of the claim, and $1,000,000 of Christiana's cash was reserved to cover the expense of litigating the claim.

The adjustments described above result in adjusted net asset value as follows:

Security holdings of Christiana	$2,226,814,066
Other assets (at June 30, 1972):	
Cash and cash equivalents, less current liabilities	5,981,367
Deferred charge—claim for tax refund	11,723,013
Total net asset value of Christiana	$2,244,518,446
Adjustments for purposes of the merger:	
Less: deferred charge for the tax claim, together with $1,000,000 for expenses thereof (no present value for merger purpose)	(12,723,013)
Less: estimated expenses and taxes upon disposal of stock of Wilmington Trust Co. and The News-Journal Co.	(7,619,606)
Less: Christiana's share of expenses of merger	(750,000)
Adjusted net asset value of Christiana for merger purposes	$2,223,425,827

A. A714-A715, A720, A731-A736; A. A666-A676